UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC.	CASE NO. 96-61376 Chapter 11
Debtors	Substantively Consolidated

APPEARANCES:

SIMPSON, THACHER & BARTLETT Attorneys for § 1104 Trustee 425 Lexington Avenue New York, New York 10017	M.O. SIGAL, JR., ESQ. Of Counsel
WASSERMAN, JURISTA & STOLZ Attorneys for Official Unsecured Creditors Committee 225 Millburn Avenue Millburn, New Jersey 07041	HARRY GUTFLEISH, ESQ. Of Counsel
GUY VAN BAALEN, ESQ. Assistant U.S. Trustee 10 Broad Street Utica, New York 13501	
HARRIS BEACH & WILCOX, LLP One Park Place 300 South State Street Syracuse, New York 13202	JOHN A. DE FRANCISCO, ESQ. Of Counsel

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court considers herein the motion filed on October 6, 1997 by Richard C. Breeden, Trustee ("Trustee") of the above referenced substantively consolidated case.

The motion seeks the appointment of the law firm of Harris Beach & Wilcox, LLP

("HBW") as "local counsel" to the Trustee. The motion was initially scheduled for argument on October 21, 1997, but was consensually adjourned to November 18, 1997. The motion is opposed by the United States Trustee ("UST") and by the Official Committee of Unsecured Creditors ("Creditors Committee"). On November 14, 1997, HBW filed a Supplemental Affidavit in support of appointment.

Oral argument on the motion was heard in Syracuse, New York on November 18, 1997. After hearing that argument, the Court requested from the Trustee a supplemental affidavit specifically outlining the role to be undertaken by HBW as "local counsel" to the Trustee and how the appointment would result in the reduction of attorneys' fees in this consolidated case. *See* follow-up letter from Court to M.O. Sigal, Esq., dated December 12, 1997. In response to the Court's request, the Trustee filed a Supplemental Affidavit and proposed order authorizing employment on December 16, 1997. On that date, the Court received correspondence from counsel to the Creditors Committee, and on December 29, 1997, the Court received correspondence from the UST responding to the Trustee's Supplemental Affidavit.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this contested matter pursuant to 28 U.S.C. §§ 1334(b) and 157(a), (b)(1) and (b)(2)(A) and (O).

FACTS AND DISCUSSION

On May 28, 1996, the firm of Simpson, Thacher & Bartlett ("STB") was appointed as general counsel to the Trustee and has continued in that capacity at all times since. Since its appointment, STB has filed four interim fee applications which have requested $10,365,492.50 in fees and $ 1,601,531.25 in reimbursement of expenses. The Court has awarded total fees of $ 6,350,186.71, together with total expenses of $ 1,166,186.16 through the date of this decision.[1]

The initial motion, which was filed on the Trustee's behalf by HBW, not STB, contends that the appointment of HBW as local counsel "will have the effect of reducing legal costs to this consolidated case." While the Trustee's Application dated October 6, 1997, was somewhat vague as to how a legal-cost savings would occur, it was supported by the affidavit of John DeFrancisco, Esq. ("DeFrancisco"), an HBW partner, which outlined the hourly rates charged by various HBW partners and associates, proposed to "discount" HBW's fees on an annual basis and outlined various exceptions to the term "disinterested person" as defined in § 101(14) of the Bankruptcy Code (11 U.S.C. §§ 101-1330) ("Code"). Upon receipt of significant objections from both the UST and the Creditors Committee, HBW filed a Supplemental Affidavit on November 14, 1997 ("November Affidavit"). The November Affidavit sworn to by DeFrancisco revealed further facts regarding HBW and DeFrancisco's relationship to the consolidated Debtor. DeFrancisco disclosed that in addition to his own personal creditor relationship to the consolidated Debtor, his son had been employed by an entity (Jameson DeWitt & Associates)

[1] The Third and Fourth interim fee applications of STB have not yet been ruled upon by the Court, although provisional awards have been made to STB relating to these fee applications.

"owned or controlled by the Bennetts."[2] *See* Affidavit of DeFrancisco sworn to the 14th day of November 1997, at ¶ 6. In addition, DeFrancisco disclosed that he had received political contributions from the Bennetts in connection with his successful candidacy for the New York State Senate in 1992, 1994 and 1996, as well as for a campaign for a citywide office in the City of Syracuse in 1985. DeFrancisco also acknowledged that he unsuccessfully sponsored special legislation on behalf of a certain Bennett family-owned business while a member of the New York State Senate. *Id.* at ¶ ¶8-13. As a condition to the appointment of HBW, DeFrancisco has offered to assign his personal claims against the consolidated Debtor to a charitable organization, and would return to the Trustee the total amount of all political contributions received from members of the Bennett family or from entities in which they played a major role.

The Trustee, in his Supplemental Affidavit filed December 16, 1997 ("December Affidavit"), asserts that he cannot be completely specific regarding the role HBW will play lest he compromise the ability to maximize estate recovery by providing potential defendants with advance warning of litigation, thereby encouraging the diversion of estate assets. Additionally, the Trustee opines that employing HBW for discreet types of litigation in the role of special counsel will limit HBW's effectiveness and spawn unnecessary future applications to the Court.

Initially the UST's objection focused on the lack of specificity as to the role HBW would undertake as "local counsel," as well as the significant number of creditors of the consolidated Debtor represented by HBW and the need for HBW to disassociate itself from further representation of these creditors. At the same time the Creditors Committee echoed the need for

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[2] Prior to the filing of the consolidated case, the Debtor entities had been owned primarily by members of the Bennett family located in Syracuse, New York.

HBW to end its representation of various creditors of the consolidated Debtors, as well as expressing its concern as to HBW's proposed role as "local counsel," fearing that it would increase rather than decrease legal expenses.

Following receipt of the November Affidavit the UST filed a supplemental affidavit which "adamantly opposes [HBW's] retention in these cases. The U.S. Trustee does not believe, from a totality of the circumstances, that the divestiture of interests or the construction of an 'informational barrier', at this juncture, would rehabilitate the instant application." *See* UST Supplemental Objection to Application of Trustee dated November 17, 1997, at ¶ 10.

The Creditors Committee, in a letter to the Court dated December 19, 1997, generally withdraws its initial opposition to the appointment of HBW as "local counsel" so long as appropriate "information barriers" are constructed around HBW's continued representation of creditors of and other parties dealing with the consolidated Debtor. The Creditors Committee also suggests that DeFrancisco transfer his personal claims for the benefit of other creditors, rather than to a charity which arguably would result in a significant tax benefit to him.

In a letter to the Court dated January 9, 1998, the UST continues to object to the appointment of HBW. In that letter, the UST posits that HBW should be required to withdraw from representing various financial institutions involved in this case, including OnBank, as well as be required to impose an informational barrier around De Francisco. The UST also reiterates the concern that the scope of HBW's retention remains unclear.

The Trustee seeks to appoint HBW pursuant to Code §§ 327(a) and (c) and argues that those sections do not prohibit HBW's simultaneous representation of both the Trustee and existing creditors as well as those entities holding interests essentially adverse to the estate so

long as no actual conflict exists. In reaching this legal conclusion, the Trustee points to the 1984 amendment to Code § 327(c). Prior to 1984, Code § 327(c) provided that a professional would not be denied appointment simply because the professional represented a creditor of the debtor so long as that representation did not continue during the pendency of the bankruptcy case. However, in 1984, Congress amended Code § 327(c) and replaced the simultaneous representation prohibition with a two pronged test which permitted such dual representation so long as (1) there was no objection from another creditor or the UST, and (2) the dual representation presented no actual conflict of interest. In reality, however, Courts do not always apply amended Code § 327(c) literally. As one noted authority has observed, "While current representation of a creditor is no longer a *per se* bar to employment by the trustee under section 327(c), an actual conflict of interest or the appearance of impropriety remains as independent grounds for disqualification," and it is further noted that "despite the clear provisions of Section 327(c), some courts have disqualified professionals in the absence of an actual conflict of interest." 3 COLLIER ON BANKRUPTCY ¶327.04 [7][b], [c], at 327-56 to 327-57 (15th ed. 1997).

Pursuant to Code § 327(a), a trustee may employ an attorney who does not hold or represent an interest adverse to the estate, and who is disinterested, in order to represent or assist the trustee in carrying out the trustee's duties under title 11. *See* 11 U.S.C. § 327(a). A disinterested person "does not have an interest materially adverse to the interest of the estate or of any class of creditors . . . by reason of any direct or indirect relationship to, connection with, or interest in the debtor . . . ." 11 U.S.C. § 101(14)(E).[3] By virtue of these overlapping

[3] "The statutory definition of 'disinterested' promotes the 'policy that professionals should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtor's estate.'" *In re Amdura Corp.*, 121 B.R. 862, 867 (Bankr. D. Colo. 1990)

requirements, courts have found that the elements of Code § 327(a) are satisfied if the attorney to be retained is a "disinterested person." *See In re Martin*, 817 F.2d 175, 181 (1st Cir. 1987); *In re Caldor, Inc. - NY*, 193 B.R. 165, 171 (Bankr. S.D.N.Y. 1996); *In re Leslie Fay Co.'s, Inc.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994).

Although the term "adverse interest" is not defined in the Code, it has been found that holding an adverse interest to the estate means

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that would render such a bias against the estate.
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> To "represent an adverse interest" means to serve as agent or attorney for any individual or entity holding such an adverse interest.

In re Roberts, 46 B.R. 815, 827 (Bankr. D. Utah 1985), *aff'd in part, modified in part, rev'd in part on other grounds*, 75 B.R. 402 (D. Utah 1987); *see In re TWI Int'l, Inc. V. Vanguard Oil and Serv. Co.*, 162 B.R. 672, 675 (S.D.N.Y. 1994); *In re Brennan*, 187 B.R. 135, 148-49 (Bankr. D.N.J. 1995). An interest is not considered adverse merely because a hypothetical conflict can be imagined. Indeed, disqualification is appropriate when an actual conflict is present, rather than a hypothetical or theoretical conflict. *See TWI Int'l*, 162 B.R. at 675. The court may still disqualify an attorney on the basis of potential conflict, however, as the test is essentially whether there is a potential actual conflict. *See id.* (citing *In re O'Connor*, 52 B.R. 892, 897 (Bankr. W.D. Okla. 1985)).

As observed in *In re Leslie Fay Companies, Inc.*, potential conflicts as much as actual

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(quoting *In re Kuykendahl Place Assocs., Ltd.*, 112 B.R. 847, 850 (Bankr. S.D. Tex. 1989)).

conflicts may cause attorneys to act in a manner contrary to the best interests of their clients. 175 B.R. at 533. Thus, rather than focusing on the potential/actual distinction, it is more appropriate to ask whether a professional has "either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors - an incentive sufficient to place those parties at more than acceptable risk - or the reasonable perception of one." *Id.* (quoting *In re Martin*, 817 F.2d at 180-81). Therefore, if representation of another interest may result in different actions being taken by the professional because of that representation, there is a conflict and an interest adverse to the estate. *See Caldor*, 193 B.R. at 171; *Leslie Fay*, 175 B.R. at 533.

Regarding the employment of a professional who represents a creditor, Code § 327(c) states that

> [i]n a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is an objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

11 U.S.C. § 327(c). In the often-cited case of *In re BH & P, Inc.*, the Third Circuit rejected a bright-line test for disqualification, instead endorsing the test posited by the bankruptcy court below which provided that a court should generally disapprove the employment of a professional with a potential conflict, with some limited exceptions. 949 F.2d 1300, 1315 (3d Cir. 1991). One exception is that in a case of large magnitude, every competent professional in a particular field may already be employed by a creditor or a party in interest, thus necessitating the challenged professional's employment.[4] The other exception occurs when the reasons for employing the

[4] While STB asserts that HBW is one of a handful of Central New York law firms not conflicted out of this case, albeit that HBW represents a numbr of creditors, that assertion is

professional are compelling, and the likelihood that the potential conflict will become actual is remote. *See id*. As noted by the Third Circuit, "[c]ourts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists 'in light of the particular facts of each case.'" *Id.* at 1315. Bankruptcy courts are to

> analyze the factors present in any given case in order to determine whether the efficiency and economy which may favor multiple representation must yield to competing concerns affecting fairness to all parties involved and protection of the integrity of the bankruptcy process. Factors to be considered include, but are not limited to, the nature of disclosure of the conflict made at the time of appointment, whether the interests of the related estates are parallel or conflicting, and the nature of the interdebtor claims made. As we have said, denomination of a conflict as "potential" or "actual" and the decision concerning whether to disqualify a professional based upon that determination in situations not yet rising to the level of an actual conflict are matters committed to the bankruptcy court's sound exercise of discretion. In order to ensure proper review of in these cases, those factors underlying the exercise of discretion "must be factually substantiated upon the evidentiary record."

In re BH & P, Inc., 949 F.2d at 1316-17 (cite omitted).

In the instant contested matter, HBW has acknowledged that it currently represents some seven financial institutions that are listed as creditors of the consolidated Debtor, a national gaming corporation which has been negotiating with the Trustee to purchase the Trustee's interest in a casino located in Reno, Nevada, the financial institution which serves as trustee of the consolidated Debtor's pension and profit sharing plans and numerous individual investor

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generally unsupported by any factual analysis.

creditors. *See* Affidavit of DeFrancisco sworn to October 6, 1997.[5] Thus, putting aside the personal involvement of DeFrancisco with the Bennett family, the disclosed potential conflicts of interest border dangerously close to actual conflicts of interest, particularly HBW's representation of the entity which is presently negotiating with the Trustee for the sale of a significant asset.[6]

As a solution to what HBW and the Trustee identify as more potential conflicts of interest, it is proposed that the court craft an order which erects "information barriers" around various members of HBW. While such barriers may be a satisfactory solution to a potential conflict in a non-bankruptcy setting, they do not solve the dilemma in this case because they are self-enforcing and, more importantly, are ineffectual to dispel the appearance of impropriety which is unique to a high profile bankruptcy case such as this one.

As the bankruptcy court in *In re American Printers & Lithographers, Inc.* observed, "§ 327 exists to protect the integrity of the bankruptcy system, *In re Ginco, Inc.*, 105 B.R. 620, 622 (D. Colo. 1988), and is designed to prevent even the possibility that professionals may compromise their representation of debtors." 148 B.R. 862, 866 (Bankr. N.D. Ill. 1992) (cite omitted). "The requirements of section 327 cannot be taken lightly, for they 'serve the important policy of ensuring that all professionals appointed pursuant to [the section] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary

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[5] HBW asserts that its representation of the seven financial institutions listed as creditors of the consolidated Debtor, with one exception, is unrelated to the instant chapter 11 case.

[6] HBW has not suggested that it will terminate its current representation of any of the disclosed entities; in fact, the Trustee in his Supplemental Affidavit asserts that HBW's continued representation of the casino purchaser and pension fund administrator is essential.

responsibilities.'" *Leslie Fay*, 175 B.R. at 532 (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994)).

While the true role that the Trustee envisions for HBW remains shrouded in tactical secrecy, the Court must rely on what limited representations have been made. At ¶ 2 of the Trustee's initial application he asserts, "4. Due to the pre-petition activities in which the debtors engaged, and due to the ongoing process of collecting and monetizing property of the estate, numerous adversary proceedings, other legal proceedings and transactions may be necessary." At the oral argument of the motion on November 18, 1997, STB's lead counsel, M.O. Sigal, Jr., advised the Court that he envisioned HBW's role as somewhat ancillary to STB, in that STB would commence numerous adversary proceedings categorized as "smaller cases" and "bulk cases" pursuant to Code §§ 544, 547 and 548, bring a select few of those proceedings to trial, optimistically obtain a favorable result on specific questions of law and then turn over the remaining litigation to HBW. This would involve the disposition of the remaining mass of anticipated adversary proceedings, but with the advantage of then binding precedent obtained by STB. For such a discreet role, appointment of HBW pursuant to Code § 327(c) is neither necessary nor warranted.

Appointing HBW as "local counsel" pursuant to the much broader authority of Code § 327(c) will not in this Court's opinion reduce the impact of professional fees, but will inevitably lead to overlapping services and impose upon this Court an even greater burden to scrutinize future fee applications of both STB and HBW. As succinctly stated by the 10th Circuit Court of Appeals in *In re Interwest Business Equipment,Inc.*,

> "[b]ecause of their experience and their familiarity with the cases, bankruptcy judges bring a unique expertise to the question of

> when simultaneous representation of multiple estates and their creditors is a conflict that works to the detriment of the estate in bankruptcy, its creditors or to the detriment of the public confidence in the integrity of the bankruptcy system. Thus we will not second guess a decision not to approve professionals under § 327 unless it exhibits a clear abuse of discretion, circumstances not present in the case at hand."

23 F.3d 311, 318 (10th Cir. 1994).

Conversely, appointment of HBW pursuant to Code § 327(e) removes the general conflict of interest concerns so long as HBW possesses no conflict with regard to the specific matter being handled. *See In re South Shore Golf Club Holding Co., Inc.*, 182 B.R. 94, 95 (Bankr. W.D.N.Y. 1995); *In re Drexel Burnham Lambert Group, Inc.*, 112 B.R. 584, 586 (Bankr. S.D.N.Y. 1990); *In re Microwave Prods. of America, Inc.*, 104 B.R. 900, 908 (Bankr. W.D. Tenn. 1989); *Altenberg v. Schiffer (In re Sally Shops, Inc.)*, 50 B.R. 264, 266 (Bankr. E.D. Pa. 1985).

Arguably, the Trustee's inability to define HBW's role so as to permit the appropriate analysis of a limited conflict may be an impediment to appointment pursuant to Code § 327(e). *See Drexel Burnham,* 112 B.R. at 586. The Trustee has outlined general parameters for HBW, which at least initially may permit the Court to analyze the existence of conflict for special counsel, although a more detailed outline would clearly define the scope of services to be rendered by HBW in contrast to those rendered by STB.

The Court in reaching its conclusion is not swayed by the Trustee's observation that "To limit HBW's representation to discreet types of litigation would result in numerous additional applications to the Court for approval each time additional matters arise, which matters might not even be contemplated at this time." *See* Supplemental Affidavit of Richard C. Breeden sworn to December 9, 1997, at ¶ 6(c). Numerous additional applications, if needed, are a small price

to pay to more effectively manage professional fees while simultaneously maintaining the integrity of the bankruptcy system, particularly in a case such as this where thousands of individual investors are alleged to have suffered significant financial hardship.

Notwithstanding the erection of a labyrinth of arguably unenforceable barriers, HBW is at the heart of simply too many forseeable conflicts of interest to authorize the Trustee to utilize its services pursuant to the open ended authority found in Code § 327(c).

Based upon the foregoing and to the extent that the Trustee seeks to appoint HBW as "local counsel" pursuant to Code §§ 327(a) and (c), the Trustee's motion is denied.

Dated at Utica, New York

this 14th day of January 1998

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge